

Tax Law Rewrite.
Response to Paper
CC/SC(07)38

Loss relief

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INTRODUCTION

1. We published Committee Paper CC/SC(07)38 in November 2007 on the HMRC internet website www.hmrc.gov.uk/rewrite. The closing date for responses was 28 February 2008. The draft clauses rewrite the loss relief provisions in Chapter 2 and Chapter 3 of Part 10 of ICTA.

2. The purpose of this response document is to provide details of the substantive points made and to explain our analysis and proposals in respect of them. Minor points such as suggestions to improve punctuation are not covered, but all comments received have been carefully considered.

3. We received written responses from the following:

- The Chartered Institute of Taxation
- The Institute of Chartered Accountants in England and Wales
- The Confederation of British Industry
- One individual

4. We are very grateful for all the comments made, many of which were detailed and we appreciate the time and effort that went into them. We are sending each respondent a copy of this response document.

5. The following abbreviations for tax legislation are used:

- FA Finance Act
- ICTA the Income and Corporation Taxes Act 1988
- ITA the Income Tax Act 2007

6. 18 questions were raised in the ENs accompanying the draft clauses. Sixteen of these received positive responses. Minor points were raised in connection with questions 6 and 12. These points are dealt with in connection with the clauses to which they relate.

Clause 3: Relief for trade losses against total profits

In subsection (4) there must be a simpler way of conveying the idea that the loss is set against the profits of the available accounting periods (if more than one) in reverse order of time. The same point applies to clauses 15(4), 29(3) and 31(6). The approach in these clauses may be contrasted with that taken in clause 32(3).

7. We have looked closely at this clause to see if the ideas might be expressed more simply. The clause has to specify the accounting period where the loss may be relieved and also the amount of that loss that may be relieved. Having considered the options we felt that the formulation used was the best way of expressing these ideas. Whilst the clause requires a little mental agility it does follow the pattern established by section 393A(1) and is therefore familiar to current users of the legislation. The same formulation has been used in other parts of the bill, for example in the share loss relief provisions.

8. ***We do not propose to amend the clause to meet this point.***

*Sub-clauses (5) and (6) translate "falling within Case V of Schedule D" as "carried on wholly outside the United Kingdom". This fails to capture the full subtlety of the definition of Case V as established by the courts. In particular most people would understand "carried on" as referring to the place where the day-to-day transactions take place, but cases such as *Ogilvie v Kitton* show that the place where the business is controlled is also relevant. It is necessary either to find a form of words which preserves the link to the existing case law on Case V or to redefine the relevant boundary, which might be preferable but would be a matter for a Finance Bill.*

9. The essence of *Ogilvie v Kitton* is to establish where the trade in that particular case was "carried on". It is true that "most people would understand "carried on" as referring to the place where the day-to-day transactions take place". However, the meaning of the words has been established by the courts and we therefore think that by using the words "carried on" in subsections (5) and (6) the link with case law has been maintained. We will amend the EN in order to cover the point.

10. ***We do not propose to amend the clause to meet this point.***

It is also at least debatable whether section 393A(3) has the effect of requiring the trade to be not within Case V in the earlier period as well as the current one, as sub-clause (6) assumes.

11. We believe that the rewrite replicates the existing legislation. Section 393A(3) provides that subsection (1) does not apply to Case V trades. Subsection (1)(b) begins "if the company was then carrying on the trade". If "the trade" is a Case V trade then the subsection cannot apply.

12. We do not propose to amend the clause to meet this point.

Sub-clause (8) should refer to losses "of", rather than "in", different accounting periods. This is not only the more usual usage, but also makes it easier for the reader to keep clear the distinction between the period in which the deduction is made, and the period to which the loss belongs.

13. We agree.

14. We propose to amend the clause to meet this point.

Clause 4: Limit on deduction if accounting period falls partly within 12 month period

Would it be appropriate to define the relevant formula, and give it a more meaningful label, using a simple formula?

15. TLR policy is to make legislation more accessible by using formulas where this would assist understanding. However, in this clause (and the subsequent one) we think that the concept is so straightforward that a formula might only serve to obscure the meaning.

16. We agree that the use of "relevant" is not particularly helpful. We have reviewed the instances where the label appears throughout the loss clauses and made the following changes;

- In clauses 4 and 5 the "relevant proportion" has become the "overlapping proportion".
- In clauses 19 and 20 the "relevant trade" has become the "limited partnership trade".
- In clause 22 the "relevant trade" has become the "LLP trade".
- In clauses 19 and 22 we have dropped the label "relevant relief". Instead the clause now refers to relief within subsection (4).
- In clause 31 we have dropped the label "relevant transaction". Instead the clause now refers to a relief within subsection 92).
- In clauses 32, 33 and 35 the references to "relevant company" have been dropped as unnecessary.

17. We propose to amend the clauses to meet this point.

Clause 6: Ring fence trade: extension of periods for which relief may be given

The opening words of subsection (4) (“if a part of the loss is a terminal loss”) seem to be redundant given the condition in subsection (1)(c).

18. We think that the condition in subsection (1)(c) might be more clearly expressed by saying “not all of the loss is a terminal loss” and then, in subsection (2), inserting after “the loss” the words “(so far as it is not a terminal loss)”. In this way it will be possible to do without subsection (4).

19. *We propose to amend the clause to meet this point..*

Clause 7 : Ring fence trades: modification of time for making claims

It would be preferable if the parenthetical notes summarising the effect of sections 165 and 416 of ICTA were to be retained.

20. We agree that it would be helpful to retain the parenthetical descriptions.

21. *We propose to amend the clause to meet this point*

Clause 8 : Trade must be commercial or carried on for statutory functions

It is noted that that subsections (1) and (3) are consistent with section 66 of ITA. However, it is felt that the law would be considerably clearer if the statutory test referred simply to the way in which the trade was carried on at the end of the accounting period.

22. Subsection (3) is only of relevance in the rare case where there has been a change, during the accounting period, in the way in which a trade is carried on. Under normal circumstances subsection (1) is all that is required. The approach is consistent with the source legislation. We don't consider that the grounds for making a change outweigh the benefits of maintaining consistency with ITA.

23. *We do not propose to amend the clause to meet this point.*

Clause 10 : Reasonable expectation of profit

The source legislation expresses the "reasonable expectation of profit" test in terms of what might reasonably be expected by, it must be assumed, an external observer. The rewrite expresses it in terms of the expectations of the competent farmer himself. There is not any particular reason for making the change and the original version does at least help to emphasise that what is required is an objective appraisal of the prospects of the business.

24. The clause follows the pattern established by section 68 of ITA which is also based on section 397 of ICTA.

25. Section 397(3)(a) of ICTA refers to “a reasonable expectation” but is not explicit as to who is to make that expectation. Section 397(3)(b) explicitly refers to the reasonable expectation of the farmer or market gardener who is undertaking the trading activity. In our view the clear implication is that if it is the reasonable expectation of the farmer or market gardener that applies in subsection (3)(b) then it is the reasonable expectation of that same farmer or market gardener that applies for the purposes of subsection (3)(a). We do not therefore believe that the rewritten clause constitutes a change.

26. *We do not propose to amend the clause to meet this point.*

Subsection (6) includes both “five” and “5”.

27. The phrase “prior 5 years” is a label in clause 9. The phrase also appears in clause 10 where it has the same meaning. It would therefore be inconsistent to replace “5” with “five”. On the other hand the expression “more than five years” is not a label. The drafting does not result in any potential for misunderstanding.

28. *We do not propose to amend the clause to meet this point.*

Clause 11: Cessation of trades

Is the word “other” necessary in subsection (2)?

29. The use of “other” serves to differentiate between a deemed cessation under this clause and a deemed cessation arising from some other provision.

30. *We do not propose to amend the clause to meet this point.*

Clause 13: Companies treated as same person as individual

The approach taken in this clause, of trying to allocate profits actually computed by reference to tax years to accounting periods, seems unnecessarily complicated particularly in view of the probability (conceded by sub-clause (3)(b)) that there may be no appropriate accounting period. It seems quite sufficient simply to require, as the source legislation does, that the loss should have arisen within the five-year period irrespective of whether it was computed by reference to tax years or accounting periods.

31. The legislation only applies in very particular circumstances. A loss-making trade of farming or market gardening must have been transferred from individuals to a company. The clause mirrors the legislation set out in section 70(3) and (4) of ITA which covers the situation where a trade passes from a company to individuals. We think that it is helpful to set out, in as straightforward a manner as possible, a methodology for allocating profits in this situation.

32. *We do not propose to amend the clause to meet this point.*

Clause 14: Dealings in commodity futures

Q6. We welcome comments on the inclusion of a definition of “arrangements” in this clause.

Will the term “arrangements” be used so often as to justify a general definition to cover the whole Bill? If so should a Bill-wide definition of “arrangements” refer to the fact that arrangements can be in writing or not in writing?

33. *We are considering these suggestions.*

Clause 15: Carry forward of trade losses against subsequent trade profits

Section 393(9) has not been rewritten. It is assumed that this is because charges on income are to be treated in the rewritten legislation in such a way as to make it otiose, but some explanation would have been welcome. The same applies in relation to clause 3 and section 393A(7) to (8).

34. The narrow definition of charges together with the requirement that excess charges must have been incurred wholly and exclusively for the purposes of the trade effectively means that excess charges can no longer arise.

35. *We propose to amend the ENs to meet this point.*

Clause 19: Restriction on reliefs for limited partners

In subsection (1)(a) it may be clearer to refer to ‘at any time’ rather than to ‘at a time’, in accord with the section 118(2) of ICTA definition of “relevant accounting period” and to possibly avoid any confusion with the requirements of clause 19(5). Similar comments apply to clause 22(1)(a) (Restriction on relief for members of LLPs).

36. We agree that greater clarity will result from replacing “a” with “any”.

37. *We propose to amend the clause to meet this point*

In subsection (4) the reference to the ‘time during which’ appears less than wholly appropriate where that time is a single date, as defined in clause 19(5). Similar comments apply to clause 22(4).

38. There is no direct connection between subsection (5) and subsection (4). The time defined in subsection (5) is referred to in subsection (3). “During” refers to the duration of the accounting period and is therefore correct. The same comments apply to clause 22(4).

39. *We do not propose to amend the clause to meet this point*

Subsection (5)(b) would be improved by inserting “the time” after “period”.

40. We agree that this would be an improvement.

41. ***We propose to amend the clause to meet this point***

Clause 20: Meaning of “contribution to the firm”

Subsections (6) and (7) could be amalgamated with a saving of space and no real loss of clarity.

42. The saving of space would be small. As it stands the subsection mirrors section 105 of ITA.

43. ***We do not propose to amend the clause to meet this point***

The reference to ‘the relevant trade or any of the other trades’ in subsection (10) is confusing, as it may point to an alternative situation, whereas the profits/losses at issue relate to the aggregate profits/losses of the relevant trade and any other trade(s) carried on by the firm. Would it be clearer to redraft clause 20(10) to refer to “... references to the profits or losses of the relevant trade were references to the aggregate of the profits or losses of the relevant trade and of the other trades”?

44. The subsection mirrors section 105(10) of ITA. We do not think that there is scope to misinterpret the subsection. If the phrase “relevant trade” in subsection (7) is replaced with the phrase “relevant trade or any of the other trades” then the subsection reads “Profits are within this subsection if they are from the relevant trade or any of the other trades.” Profits from the relevant trade are within the subsection and profits from any other trade are also within the subsection. There seems to be no scope for arguing that only profits from one or the other are within the subsection.

45. ***We do not propose to amend the clause to meet this point***

Clause 21: Meaning of “limited partner”

Q12. Change 620 reproduces Change 16 in ITA 2007 and so brings the income and corporation tax codes back into line. We welcome comments on the proposal to carry Change 16 in ITA 2007 across to corporation tax.

There is no objection to the drafting of subsection (4), which is implicit in section 118(2)(c) of ICTA and which enables references to the firm to be read as references to the relationship between the company and the other persons mentioned in clause 21(3)(a), but the cited source, Change 620 (reproducing Change 16 in ITA), does not obviously cover this aspect.

46. The change referred to in paragraph 66 of the ENs is simply the replacement of “contribution to the trade” with “contribution to the firm”. The approach mirrors that in ITA in relation to section 106(4) and Change 16. It was not considered that the enabling of references to the firm to be read as references to the relationship between the company and the other persons mentioned in clause 21(3)(a) constituted a change as this was, as stated, implicit in section 118(2)(c) of ICTA.

47. *We do not propose to amend the change note to meet this point.*

Clause 22: Restrictions on relief for members of LLPs

Is there any reason for the difference in drafting of clause 22(1)(a) and clause 19(1)(a)?

48. The clauses mirror the format adopted in ITA (sections 107 and 104).

49. *We do not propose to amend the clauses.*

Clause 23: Meaning of “contribution to the LLP”

Is there any reason for the difference in drafting of clause 23(1) and clause 20(1)?

50. Once again the clauses mirror the format adopted in ITA (sections 108 and 105).

51. *We do not propose to amend the clauses.*

Clause 25: Relief for losses made in UK property business

As drafted, the effect of clause 25(1) to (5) is that a property business loss can be carried forward through any number of accounting periods until it is relieved against that business’s ‘net profits’ which appear to comprise the property business profits together with any other income and gains arising (see Explanatory Notes paragraph 77). This is more liberal than the relief for trading losses under clause 15, which is against future trading profits only. This correctly rewrites the section 392A(1) and (2) of ICTA relief against ‘total profits’ of however many accounting periods, until a Schedule A loss is relieved. Is this different treatment intended? By way of contrast, loss relief under clause 29, in the case of an overseas property business, is set against the profits from that business only (excluding any chargeable gains).

52. The property business loss is not set against a company’s net profits but is set against its total profits in the process of arriving at its net profits in accordance with subsection (3). This relief is indeed more liberal than that available under clause 15.

53. *We do not propose to amend the clause.*

Clause 26: Company with investment business ceasing to carry on UK property business

Does it need to be made clear in clause 26(2)(b) that the unrelieved loss is treated as an expense of management deductible only in the accounting period next after the one in which the UK property business ceases; or is it instead intended that ‘the purposes of section 75 of ICTA’ will also include section 75(9) of ICTA, so that any loss still unrelieved in the period following the cessation could be further carried forward and relieved against total profits of later accounting periods throughout which the investment business is carried on until wholly relieved?

54. Once the unrelieved loss is treated as an expense of management it loses its character as an unrelieved loss. Section 75(9) of ICTA will therefore apply as it does to all expenses of management. In order to resolve any perceived ambiguity we will redraft the section.

55. *We will amend the clause to meet this point.*

Clause 27: UK property business to be commercial or carried on for statutory functions

Subsections (1) and (3) are consistent with ITA 2007 section 66. However, the law would be considerably clearer if the statutory test referred simply to the way in which the property business was carried on at the end of the accounting period. Under the current draft one has to consider first how the property business was carried on during the accounting period (subsection (1)) but then realise that it is really only the conduct at the end of the period that counts (subsection (3)).

56. The point is the same one as that made in relation to clause 8. Our comments at paragraph 22 apply.

57. *We do not propose to amend the clause to meet this point.*

Clause 28: UK furnished holiday lettings business treated as trade

It is not immediately clear how subsection (6) can apply given that all a company’s furnished lettings businesses are to be treated as a single trade (section 503(1)(b)). If it is to be given the meaning set out in the Explanatory Notes, then perhaps the inclusion of the words “in different capacities” would assist matters.

58. Having reviewed the associated legislation we agree that subsection (6) cannot apply and the associated EN is incorrect. Subsection (6) will be dropped and the EN redrafted.

59. *We propose to amend the clause to meet this point*

Clause 30: Overseas property business to be commercial or carried on for statutory functions

Subsections (1) and (3) are consistent with section 66 of ITA. However, the law would be considerably clearer if the statutory test referred simply to the way in which the property business was carried on at the end of the accounting period. Under the current draft one has to consider first how the property business was carried on during the accounting period (subsection (1)) but then realise that it is really only the conduct at the end of the period that counts (subsection (3)).

60. The point is the same one as that made in relation to clause 8. Our comments at paragraph 22 apply.

61. *We do not propose to amend the clause to meet this point.*

Clause 31: Relief for losses from miscellaneous transactions

How is it intended to rewrite section 396(2) of ICTA (Case VI losses) which disapplies the source section 396(1) of ICTA in the case of sections 34 to 36 of ICTA or on a disposal to which Chapter 5 of Part 17 of ICTA applies?

62. Taking sections 34 to 36 of ICTA first. Section 396(2) of ICTA excludes losses arising on lease premiums etc chargeable under sections 34 to 36 of ICTA. That exclusion now operates only in respect of any such losses which arise prior to the FA 1998 substitution of the Schedule A charge in those sections for the former Case VI charge. The retention of subsection (2) after FA 1998 (and the rider in subsection (1)) served to prevent any claim against subsequent Case VI income for such earlier losses. If, as intended, the rewrite of section 396 follows the income tax approach, the need for this exclusion falls away. That is, the rewritten relief applies by reference to a list of provisions under or by virtue of which a profit or gain would be charged, which list would, of course, not include sections 34 to 36.

63. *We do not propose to amend the clause to meet this point.*

64. The reference to Chapter 5 of Part 17 of ICTA is more problematic. The reference was inserted by section 57 of FA 2007 as part of a package of measures amending the Offshore Funds legislation.

65. Paragraph 3(5) of Schedule 28 of ICTA provides that where a computation of gain under Schedule 28 would give rise to a loss, the gain on the disposal is deemed to be nil and, for the purposes of the offshore fund rules, no loss arises on the disposal. The loss has always been considered to be a capital loss which can be utilised under the rules in TCGA 1992.

66. However, section 152 of ITA (for income tax) and section 396 of ICTA (for corporation tax) could have potentially allowed claims for the loss computed under Schedule 28 to be set against profits under provisions listed in section 1016 of ITA

(income tax) and profits under Schedule D Case VI (corporation tax). These sections were therefore amended. The section 396 amendment refers to a disposal to which Chapter 5 of Part 17 applies. The section 152 amendment refers to income tax charged under section 761(1)(b)(i) of ICTA.

67. That element of section 396(2) that deals with Chapter 5 of Part 17 will need to be rewritten. Provided that the Bill 6 equivalent of section 1016 only refers to section 761 of ICTA (of the various measures in Chapter 5 of Part 17) then the rewritten section 396(2) need only refer to this one section.

68. The reference to Chapter 5 of Part 10 of Bill 5 will be amended to refer to the corporation tax equivalent of section 1016 of ITA.

69. *We propose to amend the clause to meet this point.*

Clause 32: Loss relief to be reduced in case of write-off of government investment

The written-off amount goes to reduce the carry-forward losses. Would it be better to be explicit about this rather than saying that the written-off amount is “set off against” those losses?

70. “Set off” is used in the source legislation. We do not think that there is any real ambiguity. However, we are considering this point in the context of the Bill as a whole.

71. *We are considering amending the clause to meet this point.*

Clause 33: Groups of companies

One correspondent wonders who decides which companies’ losses are to be reduced.

72. The set off against carry forward losses must be just and reasonable. The group must therefore decide what constitutes a just and reasonable allocation amongst group companies.

73. *We do not propose to amend the clause to meet this point.*

Clause 34: Cases in which government investment is written off

Should the reference in Case 1 be to a liability’s being reduced or extinguished?

74. The clause applies solely to the element that has been written off/extinguished and there is therefore no need to refer to a liability being reduced.

75. We do not propose to amend the clause to meet this point.

Why is it no longer considered necessary in Case 3 to refer to a reduction as including a reduction to nil?

76. In order to avoid the argument that a reduction cannot include a total extinguishment we intend reinstating the words in parentheses from the source legislation.

77. We propose to amend the clause to meet this point.